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**Supreme Court of the United States**

OCTOBER TERM, 1945

No. 36

**THE JOHN KELLEY COMPANY**  
Petitioner

**COMMISSIONER OF INTERNAL REVENUE**

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT  
OF APPEALS FOR THE SEVENTH CIRCUIT

**BRIEF FOR THE PETITIONER**

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### **Opinions Below**

The opinion of the Tax Court of the United States (R. 33-40) is reported in 1 T. C. 457. The opinion of the Circuit Court of Appeals (R. 55-59) is reported in 146 F. (2d) 466.

### **Jurisdiction**

The judgment of the Circuit Court of Appeals was entered on December 21, 1944 (R. 60). Petition for Writ of Certiorari was filed on February 14, 1945, and granted on April 30, 1945 (R. 61). Jurisdiction of this Court rests on Sec. 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

## Questions Presented

The following questions are presented:

(1) Did the Circuit Court of Appeals for the Seventh Circuit have the right to reverse the decision of the Tax Court on the basis of a fact finding made by the Circuit Court, which finding is diametrically opposed to the finding made by the Tax Court?

(2) Were the debentures issued by the Petitioner, on July 1, 1937, bonds, with the result that the payments made in connection therewith were interest within the provisions of Sec. 23 (b) of the Internal Revenue Code (53 Stat. 867, 880; Title 26, U. S. C., Sec. 23 (b)), and identical provisions of the Revenue Acts of 1936 and 1938, or were they stock, with the result that the payments made in connection therewith were dividends within the provisions of Sec. 115 of the Internal Revenue Code (53 Stat. 46, as amended by 53 Stat. 873; Title 26 U. S. C., Sec. 115) and similar provisions of the Revenue Acts of 1936 and 1938?

## Statute Involved

Section 23 of the Revenue Act of 1936 (c. 690, Sec. 23, 49 Stat. 1658); Section 23 of the Revenue Act of 1938 (c. 289, Sec. 23, 52 Stat. 460); and Section 23 of the Internal Revenue Code (53 Stat. 12, as amended June 29, 1939, c. 247, Title II, Secs. 211 (a), 224, 53 Stat. 867, 880) all provide:

“Section 23. Deductions from gross income. In computing net income there shall be allowed as deductions:

“(b) Interest. All interest paid or accrued within the taxable year on indebtedness.” \* \* \* (Balance of section not applicable.)

### Summary Statement of the Matter Involved

The Petitioner is an Indiana Corporation, with its principal place of business at Marion, Indiana (R. 34). On January 1, 1937, the Petitioner had outstanding 1,124 shares of preferred stock of a par value of \$100.00 per share (R. 34). Roy F. Kelley individually owned 628 shares of the preferred stock, and he held the balance of 496 shares as Trustee for his sister, Mabel K. Ronald (R. 34). During the month of January 1937, Roy F. Kelley transferred his 628 shares of preferred stock to Mabel K. Ronald, to be held by her as Trustee for the benefit of her daughters, with a life interest in Birdena Kelley, the wife of Roy F. Kelley (R. 34).

During the month of January 1937, a special meeting of the Board of Directors of the Petitioner Corporation was held, and a plan of recapitalization was adopted (R. 34). Following this meeting, and on the same date, the shareholders of the Petitioner Corporation held a special meeting and approved the resolution adopted by the Board of Directors (R. 34). This resolution authorized the issuance of income debentures, aggregating the sum of \$250,000, bearing interest at the rate of 8% per annum, and authorized the execution of a trust instrument, setting forth the terms and conditions under which the debentures were to be issued, and setting forth the powers and duties of the Trustees (R. 34 and 35). Under the resolution, the bonds were to be offered by the Trustees in exchange for the outstanding 1,124 shares of preferred stock on the basis of \$102.00 in face value of debentures for each share of preferred stock, and for the purpose of raising additional capital to expand the business of the Petitioner in the field of finance, the Trustees were to offer any and all unissued debentures for sale at face value to the shareholders of the corporation (R. 35).

The trust agreement was entered into, and on July 1, 1937, the holders of the 1,124 shares of preferred stock



surrendered their stock to the corporation and received bonds in the face amount of \$114,648. On the same date, Mabel K. Ronald subscribed for \$24,408 of the bonds, and Birdena Kelley subscribed for \$10,944 of the bonds. These amounts were carried against Mabel K. Ronald and Birdena Kelley in open accounts on the books of the Petitioner Corporation, and the liability was later satisfied by the credit of dividends received by them on common stock which they owned (R. 35).

During the period from July 1 to December 31, 1937; January 1 to December 31, 1938, and January 1 to December 31, 1939, the Petitioner had outstanding bonds of a face amount of \$150,000, in respect of which \$6,000, \$12,000, and \$12,000 for each period, respectively, were set up on the books of the Petitioner Corporation as accrued interest thereon. The amounts so accrued were paid and were claimed by the Petitioner as deductions in computing its taxable net income for the respective calendar years 1937, 1938 and 1939. These deductions were disallowed by the Respondent on the theory that the payments represented dividends on stock and not interest on indebtedness (R. 36 and R. 8, par. (b)). The Tax Court of the United States reversed the action taken by the Respondent, and held that the debentures were bonds, with the result that the amounts paid in connection therewith were interest payments which the Petitioner was entitled to deduct in arriving at net income (R. 33, *et seq.*).

The Commissioner of Internal Revenue appealed the decision of the Tax Court to the Circuit Court of Appeals for the Seventh Circuit. That court reversed the decision of the Tax Court on the basis of its own finding of fact that the issuance of the bonds was not bona fide, which finding is diametrically opposed to the finding of fact made by the Tax Court. The Circuit Court based its conclusion upon its finding of fact that "It was all a matter of accounting hocus-pocus, guided by a little too clever legal planning which eventuated in a rather flimsy scheme to avoid payment of

taxes" (R. 59). This finding of fact upon which the determination of the Circuit Court rests, is the direct opposite of the finding made by the Tax Court; namely, that the transaction was bona fide, and that as a result thereof, the bondholders became creditors of the Petitioner Corporation (R. 40).

### **Specification of Errors to Be Urged**

The Circuit Court of Appeals erred:

1. In assuming jurisdiction to make a finding of fact that the issuance of the bonds by Petitioner was "all a matter of accounting hocus-pocus" (R. 59), which finding by the Circuit Court of Appeals is diametrically opposed to the finding of the Tax Court that the issuance of the bonds was bona fide and that as a result thereof the bondholders became creditors of the Petitioner Corporation.

2. In stating that "There is no dispute as to the facts" (R. 55), and then changing the keystone fact upon which the decision of the Tax Court rested.

3. In holding that the issuance of the bonds did not create the relationship of debtor and creditor between the Petitioner Corporation and the bondholders.

4. In holding that the instruments involved are preferred stock and not bonds.

5. In reversing the judgment of the Tax Court.

### **Summary of Argument**

#### **I**

The Petitioner is contending that the Circuit Court of Appeals clearly erred in not only ignoring an essential fact

found by the Tax Court, but in actually basing its decision on a finding of fact made by it, which is diametrically opposed to the finding made by the Tax Court. The Petitioner contends that this action on the part of the Circuit Court of Appeals is in direct conflict with the decisions of this Court in the cases of *Dobson v. Commissioner of Internal Revenue*, 320 U. S. 489, *Commissioner v. Scottish American Investment Company, Ltd.*, 323 U. S. 119, *Choate v. Commissioner*, 324 U. S. 1, *Commissioner v. Wemyss*, 324 U. S. 303, as well as other decisions by this Court cited in footnote (22) in the Dobson case.

## II

The Petitioner is further contending that from the standpoint of the merits, the decision of the Tax Court in holding that the instruments involved are bonds, is correct and that the decision of the Circuit Court of Appeals for the Seventh Circuit in holding that the instruments are stock, is in direct conflict with the decision of the Circuit Court of Appeals for the First Circuit in the case of *Comm. v. H. P. Hood & Sons, Inc.*, 141 Fed. (2d) 467, as well as other cases involving the same point.

## ARGUMENT

### Point I

THE DECISION OF THE CIRCUIT COURT OF APPEALS IS CLEARLY IN CONFLICT WITH THE DECISIONS OF THIS COURT IN THE CASES OF *DOBSON v. COMMISSIONER*, 320 U. S. 489; *COMMISSIONER v. SCOTTISH AMERICAN INVESTMENT COMPANY, LTD.*, 323 U. S. 119, AS WELL AS MANY OTHER SIMILAR CASES DECIDED BY THIS COURT.

Under date of December 20, 1943, this Court decided the case of *Dobson v. Commissioner of Internal Revenue*, 320



U. S. 489, and set forth the circumstances under which a Circuit Court of Appeals may, and may not reverse a decision of the Tax Court of the United States. In the Dobson case, this court said:

"The judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the Administrative body."

This Court further said:

"When the Court cannot separate the elements of a decision, so as to identify a clear-cut mistake of law, the decision of the Tax Court must stand."

The Circuit Court of Appeals for the Seventh Circuit found no "clear-cut mistake of law" in the instant case. It merely refused to recognize a finding of fact made by the Tax Court; namely, that the issuance of the bonds was a bona fide transaction. It made its own finding of fact; namely that the transaction was "all a matter of accounting hocus-pocus" (R. 59), which finding is the direct opposite of the finding made by the Tax Court. The decision of the Circuit Court of Appeals is based squarely on the afore-said finding of fact made by it. Even before the decision by this Court in the Dobson case, it was an established rule of appellate jurisprudence that an appellate court could not disturb the facts found by the trial court, unless there was no evidence to support the finding. There was abundant evidence before the Tax Court to support its finding that the issuance of the bonds was bona fide, and, therefore, the Circuit Court of Appeals for the Seventh Circuit had no authority to reverse this finding.

In the Dobson case, this Court further said:

"Where no Statute or Regulation controls, the Tax Court's selection of the course to be followed is no more reviewable than any other question of fact."

"The Statute gives no inkling as to the correctness or incorrectness of the Tax Court's view, and we can find no compelling reason to substitute our judgment."

The foregoing statements apply with compelling force in the instant case. There is absolutely nothing in the Internal Revenue Code that in any way aids in the solution of the problem as to whether an instrument is a bond or a preferred stock. Neither the word "bond," nor the word "stock," is defined in the Internal Revenue Code, and as far as the decision in this case is concerned, the Tax Court could have reached its conclusion without referring to the Internal Revenue Code. Consequently, this is the very type of case which this Court had in mind when it made the above statements in the Dobson case. The principle of the Dobson case has been cited and followed by every Circuit Court of Appeals, and as a matter of fact, it has been followed by the Circuit Court of Appeals for the Seventh Circuit in the cases of *George F. Fox v. Harrison*, 145 Fed. (2d) 521, and *Superior Coal Company v. Commissioner*, 145 Fed. (2d) 597.

A case which more clearly establishes error on the part of the Circuit Court of Appeals in the instant case is that of *Commissioner v. Scottish American Investment Company, Ltd.*, 323 U. S. 119, decided by this Court on December 4, 1944, for the reason that the decision of the Tax Court in that case rested squarely on its finding of fact that a certain transaction was bona fide. The sole question in the case was whether an office maintained in the United States by three foreign corporations was a bona fide office or a sham. The Tax Court found as a fact that the office maintained by the taxpayers was a bona fide office, and it therefore decided the case in favor of the taxpayers. The Third Circuit reversed the Tax Court on the basis of its own finding of fact that the office maintained in the United States by the taxpayers was a sham. This Court reversed the Third Circuit, and held that court had no right to disturb the finding of the Tax Court. During the course of its opinion, this Court said:

"The sole issue revolves about the propriety of the *inferences and conclusions* drawn from the evidence by the Tax Court." (Italics supplied.)

"The Tax Court has the primary function of finding the facts in tax disputes, weighing the evidence, *and choosing from among conflicting factual inferences and conclusions* those which it considers most reasonable. *The Circuit Court of Appeals has no power to change or add to those findings of fact, or to re-weigh the evidence.*" (Italics supplied.)

"The judicial eye must not in the first instance rove about, searching for evidence to support other conflicting inferences and conclusions which the judges or the litigants may consider more reasonable or desirable."

"We cannot say that it was unreasonable for the Tax Court to conclude that this office was more than a sham, and that it was used for the regular transaction of business."

"We do not decide or infer that the contrary inferences and conclusions urged by the Commissioner are entirely unreasonable or completely unsupported by any probative evidence. We merely hold *that such conditions are irrelevant*, so long as there is adequate support in the evidence for what the Tax Court has inferred. *It follows that the Tax Court's conclusions in this case cannot be set aside on appellate review.*" (Italics supplied.)

All of the foregoing language applies with compelling force to the action of the Circuit Court of Appeals in reversing the Tax Court in the instant case. The court held a transaction to be a sham in the face of a contrary fact finding by the Tax Court that it was bona fide. This Court in the Scottish American Investment Company, Ltd., case said that this is clearly reversible error. The Scottish American

Investment Company, Ltd., case was decided by this Court 17 days before the decision of the Circuit Court of Appeals in the instant case was released. The Circuit Court of Appeals in its opinion did not even mention the Scottish American Investment Company, Ltd., case, nor did it mention the Dobson case, although both of these cases were called to its attention before its opinion was released. The Circuit Court of Appeals cited as its authority for reversing the Tax Court, its own decision in the case of *Commissioner v. Meridian & Thirteenth Realty Company*, 132 Fed. (2d) 182, which was decided on November 5, 1942, long before this Court announced the applicable rule in the Dobson case.

The Scottish American Investment Company, Ltd., case is also of major importance from another angle. In that case, this Court said that the general principle of the Dobson case applies with the greatest possible force, where the decision of the Tax Court is such that the particular case will be "of little value as precedent." In this connection, this Court said:

"Moreover, this case exemplifies one type of factual dispute where judicial abstinence should be pronounced. The decision as to the facts in this case, like analogous ones that precede it, is of little value as precedent. The factual pattern is too decisive and too varied from case to case to warrant a great expenditure of appellate court energy on *unravelling conflicting inferences*. The skilled judgment of the Tax Court, which is the basic fact-finding and *inference-making body* should thus be given wide range in such proceedings." (Italics supplied.)

The Circuit Court of Appeals, by its own admission, recognized that the instant case is one falling squarely within the above category. At R. 56, the Circuit Court of Appeals said:

"In deciding cases of this kind, the various provisions of the instrument evidencing the obligation in the light of the surrounding circumstances in each case

determine whether the relationship created is proprietary or that of debtor-creditor. *Each case stands on its own feet.*" (Italics supplied.)

The Circuit Court of Appeals readily admitted that each case involving the question that is present in the instant case "stands on its own feet," but regardless of this admission and regardless of the fact that the Circuit Court of Appeals had the benefit of the decision of this Court in the Scottish American Investment Company, Ltd., case before it decided the instant case, it took it upon itself to reverse the Tax Court, in direct violation of the admonition set forth by this Court in the Scottish American Investment Company, Ltd., case. Furthermore, in its opinion (R. 55), the Circuit Court of Appeals said, "There is no dispute as to the facts," but regardless of this statement, the Circuit Court then proceeded to not only ignore the finding of the Tax Court that the transaction was bona fide, but to actually make its own finding, which is diametrically opposed to the finding of the Tax Court.

Under date of January 29, 1945, this Court decided the case of *W. G. Choate v. Commissioner*, 324 U. S. 1. In the Choate case, the decision of the Tax Court in favor of the taxpayer turned upon its finding of fact that a cash sale of equipment had been made. The Circuit Court of Appeals for the Tenth Circuit reversed the Tax Court. This Court, in holding that the decision of the Tax Court was not reviewable by the Circuit Court of Appeals, said:

"In the second place, the Tax Court found that the parties intended a cash sale of the equipment. That question is argued here as if it were open for redetermination by us. It is not. It is the kind of issue reserved for the Tax Court under *Dobson v. Commissioner*, 320 U. S. 489, and *Wilmington Company v. Helvering*, 316 U. S. 164, 167-168."

It will be noted that in the Choate case, the Tax Court found that the parties *intended* a cash sale of the equipment,



and that this determination by the Tax Court was not reviewable by the Circuit Court of Appeals. In the instant case, the net effect of the holding of the Tax Court (R. 40) was that by the issuance of the debentures, the holders thereof intended to, and did, become creditors of the corporation, and that they had "the right to change to the creditor-debtor basis." The entire foundation of the decision of the Circuit Court of Appeals is based upon its finding of fact that the holders of the debentures did not become creditors of the corporation, which finding is in direct opposition to the finding of the Tax Court.

Under date of March 5, 1945, this Court decided the case of *Commissioner v. Wemyss*, 324 U. S. 303. In this case the Tax Court had held that the full value of stock transferred to the prospective wife of the donor, in order to compensate her against the loss of her interest in a trust should she marry the donor, was subject to the gift tax. The Circuit Court of Appeals for the Sixth Circuit reversed the Tax Court and held that there was no "donative intent." This Court, in holding that the Circuit Court of Appeals had no authority to reverse the Tax Court, said:

"The Tax Court in effect found the transfer of the stock to Mrs. More was not made at arm's length in the ordinary course of business. It noted that the inducement was marriage, took account of the discrepancy between what she got and what she gave up, and also to the benefit that her marriage settlement brought to her son. These were considerations the Tax Court could justifiably heed, and heeding, decide as it did. Its conclusion on the issue before it was no less to be respected than were the issues which we deemed it was entitled to decide as it did in *Debson v. Commissioner*, 320 U. S. 489, *Commissioner v. Heininger*, 320 U. S. 467, *Commissioner v. Scottish American Co.*, 323 U. S. 119."

In the instant case, the Tax Court found that the issuance of the bonds was an arms-length transaction in the ordinary

course of business. The Circuit Court of Appeals ignored this holding, and concluded that the issuance of the bonds was merely "accounting hocus-pocus" (R. 59). The decision of this Court in the Wemyss case clearly shows that the holding of the Tax Court in the instant case was final, and that it was not subject to review by the Circuit Court of Appeals.

Under date of March 12, 1945, this Court decided the case of *Commissioner v. Court Holding Company*, 324 U. S. 331. The question in this case was whether a certain sale of property had been made by a corporation, or if the sale had been made by the stockholders after the corporation had been "liquidated." The Tax Court held that the corporation was taxable on the gain. The Circuit Court of Appeals for the Fifth Circuit reversed the Tax Court, and held that the sale had been made by the stockholders. This Court reversed the Circuit Court and said:

"The answer depends upon whether the findings of the Tax Court that the whole transaction showed a sale by the corporation rather than by the stockholders were final and binding upon the Circuit Court of Appeals."

"The Tax Court concluded from these facts that despite the declaration of a 'liquidating dividend' followed by the transfers of legal title, the corporation had not abandoned the sales negotiations; that these were mere formalities designed 'to make the transaction appear to be other than what it was,' and thus avoid tax liability. The Circuit Court of Appeals *drawing different inferences from the record*, held that the corporation had 'called off' the sale, and treated the stockholders' sale as unrelated to the prior negotiations. (Italics supplied.)

"There was evidence to support the findings of the Tax Court, and its findings must therefore be accepted by the courts. *Dobson v. Commissioner*, 320 U. S. 489; *Commissioner v. Heininger*, 320 U. S. 467; *Commissioner v. Scottish American Investment Co.*, 323 U. S. 119."

The decision of this Court in the Court Holding Company case again clearly shows that the Seventh Circuit had no authority to reverse the Tax Court in the instant case.

It is interesting to note how the Commissioner of Internal Revenue can vacillate in his arguments, depending upon which side of a particular case he happens to be on. No better statement of the position of the Petitioner in the instant case could be made than the argument advanced by the Commissioner in his brief filed with this Court in the *Court Holding Company* case (No. 581, October term, 1944). At page 11 of the Commissioner's Brief in that case, he said:

"Insofar as the decision below is premised on the inference that taxpayer abandoned the oral agreement and made a bona fide liquidation distribution, it violates the settled principle that it is the function of the Tax Court, not the Circuit Court of Appeals, to weigh the evidence, find the facts, and draw inferences from the facts. *Dobson v. Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231; *Wilmington Co. v. Helvering*, 316 U. S. 164, 168; *Commissioner v. Scottish American Investment Co.*, decided by this Court December 4, 1944, not yet reported.

"In assuming that the oral agreement was 'called off' (R. 120), the majority of the court below substituted its own view of the facts for that of the Tax Court."

On page 12 of the same Brief, the Commissioner said:

"In assuming that the corporation was 'actually' liquidated (R. 120), the majority of the court below likewise substituted its own view of the facts for that of the Tax Court. For the Tax Court had concluded (R. 96-97) that the resolutions to liquidate and the liquidation distribution were not bona fide but 'were formal devices to which resort was had only in the attempt to make the transaction appear to be other than what it was.'"

On page 13 of the same Brief, the Commissioner said:

"And in reaching the ultimate conclusion that the sale was in fact and substance a sale by the stockholders individually, the majority of the court below replaced the inference drawn by the Tax Court with its own."

If the foregoing statements represent sound deductions from the Dobson and the Scottish American Investment Company decisions (and this Court in deciding the Court Holding Company case said that they did), then they are also sound when applied to the arguments of the Petitioner in the instant case.

Let us now see what the Commissioner said in his Brief filed with this Court in the *Wemyss* case (No. 629, October term, 1944). At page 25 of that Brief, the Commissioner said:

"Certainly the record contains ample evidence to sustain a finding that the transaction was a family arrangement, made with donative intent, not a business deal or bargain, at arm's length. Such a finding, implicit in the findings and opinion of the Tax Court, is entitled to finality. *Dobson v. Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231; *Commissioner v. Scottish American Investment Co.*, decided by this Court, December 4, 1944.

"Going beyond its powers in entering into such an inquiry, the court below found that the prospective wife bargained 'at arm's length' (R. 56), that the transaction was 'business-like' in nature (R. 56), that the consideration for the transfer was not only a promise to marry, as the Tax Court had found (R. 13, 14), but also 'a concomitant surrender by the transferee of a life income in an existing trust fund' (R. 56) and that (R. 57)—

"She was agreeing upon a present transfer made to indemnify her against loss of existing property rights which would ensue in consequence of her marriage.

"The court below also chose to infer that the transfer was completely disassociated from any indicia of an

intent to avoid death taxes, that the minds of the contracting parties were not upon the effect of the transfer in the event of the death of either (R. 57), and finally, found that there was no donative intent in the transaction and held that the case was '*sui generis*, easily and correctly justiciable' (R. 57) upon this ground. This was not a necessary inference from the record, and it cannot be said that no other conclusion had substantial basis in the evidence and that a finding of donative purpose could not have been sustained on this record. On the contrary, we urge that a finding of donative intent is implicit in the Tax Court's finding and in the facts found by it and that the evidence supplies a substantial basis for such a finding."

The Tax Court in the instant case held that by the issuance of the bonds, the holders thereof intended to, and did, become creditors of the corporation, and in accordance with the very arguments which the Commissioner made in the briefs referred to above (which arguments were approved by this Court in its decisions covering the cases), the decision of the Tax Court in this respect was final.

Under date of May 21, 1945, this Court decided the case of *Commissioner v. Bedford*, 325 U. S. —, 65 S. Ct. 1157, and held that cash received in connection with a recapitalization was taxable as an ordinary dividend under Sec. 112 (c) (2) of the Revenue Act of 1936. The Tax Court had held that the cash received was a taxable dividend. The Circuit Court of Appeals for the Second Circuit reversed the Tax Court and held that the transaction resulted in capital gain. This Court reversed the decision of the Second Circuit. In the last sentence of the opinion, this Court said:

"And if the case can be reduced to its own particular circumstances, rather than turn on a generalizing principle, we should feel bound to apply *Dobson v. Commissioner*, 320 U. S. 489, and sustain the Tax Court."

The Circuit Court of Appeals for the Seventh Circuit not only admitted that the instant case "can be reduced to its



own particular circumstances" but it went further and stated that each case of this type *must* stand "on its own feet" (R. 56). In the light of this admission, the above-quoted language by this Court clearly demonstrates the error of the Seventh Circuit in its decision in this case.

And even in the case of *Bingham's Trust v. Commissioner*, 325 U. S. —, 65 S. Ct. 1232, decided by this Court on June 4, 1945, wherein the majority members of this Court held that the Dobson case did not apply to the facts and the law in the case, this Court was careful to point out that it was not the type of case where it was necessary for the Tax Court "to draw an inference of fact from the basic findings." In the course of its opinion, this Court said:

"And even when they are hybrid questions of 'mixed law and fact,' their resolution, because of the fact element involved, will usually afford little concrete guidance for future cases, and reviewing courts will set aside the decisions of the Tax Court only when they announce a rule of general applicability, that the facts found fall short of meeting statutory requirements. *Dobson v. Commissioner*, *supra*, 502; *Commissioner v. Estate of Bedford*, No. 710, decided May 21, 1945; cf. Paul, 'Dobson v. Commissioner,' 57 Harv. Law Rev. 753, at 828-832, 836-837."

In a concurring opinion by Mr. Justice Frankfurter, in which Mr. Justice Roberts and Mr. Justice Jackson joined, it was stated that the decision of the Second Circuit should be reversed and the decision of the Tax Court sustained, solely on the basis of the Dobson principle.

In the Bingham case there was involved a question of statutory construction. In the instant case, no such question is involved. The Petitioner has no quarrel with the Respondent as to the meaning of the word "indebtedness" or the word "interest" as used in Sec. 23 of the Internal Revenue Code. The argument centers around a matter wholly outside the Internal Revenue Code; namely, whether under the circumstances of the case the relationship of debtor

# MICRO CARD

TRADE MARK



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and creditor was established between the Petitioner Corporation and the holders of the instruments involved. Once this problem is solved, then the application or the non-application of Sec. 23 of the Internal Revenue Code is automatic. And in the determination of the question as to whether the relationship of debtor and creditor does exist, the primary question to be considered is the intent of the parties. In the case of *Commissioner v. Proctor Shop, Inc.*, 82 F. (2d) 792, the Circuit Court of Appeals for the Ninth Circuit said: "The real intention of the parties is to be sought." This is certainly a question for determination by the Tax Court and not the Circuit Court of Appeals. As the Circuit Court of Appeals for the Second Circuit said in footnote (2) in the case of *Janeway v. Commissioner*, 147 F. (2d), 602:

"Involved is the question of the credibility of the witness as to the taxpayer's intentions, a question, surely, for the Tax Court."

The Tax Court in the instant case found, after considering all of the facts, that the relationship of debtor and creditor existed. The Circuit Court of Appeals by drawing different inferences from the facts found that this relationship did not exist. In doing so, it clearly committed error, as demonstrated by the decisions of this Court, referred to above.

The decision of the Seventh Circuit in the instant case is in direct conflict with its own decisions in the cases of *George F. Fox v. Harrison*, 145 F. (2d) 521, and *Superior Coal Company v. Commissioner*, 145 F. (2d) 597, both of which cases were decided by the Seventh Circuit prior to the release of its decision in the instant case. In the Fox case, the trial court found as a fact that the redemption of stock by a corporation was not accomplished at such time and in such manner as to make the redemption essentially equivalent to the distribution of a taxable dividend within the meaning of Sec. 115 (g) of the Internal Revenue Code. The taxpayer appealed the decision of the trial court to the

Circuit Court of Appeals for the Seventh Circuit. The Circuit Court of Appeals for the Seventh Circuit, on the authority of the Dobson case, held that it was without power to reverse the decision of the lower court. It will be noted that in the Fox case, the Circuit Court of Appeals held on the authority of the Dobson case, that it could not reverse the decision of the trial court, which had held that the distribution was not a dividend within the meaning of Sec. 115 (g) of the Internal Revenue Code. In the instant case, the Tax Court found that the distributions were interest payments and not dividends within Sec. 115 of the Internal Revenue Code, yet the Circuit Court of Appeals reversed the conclusions of the Tax Court, and held that the distributions were dividends within the meaning of that section.

In the Superior Coal Company case, the Tax Court had found as a fact that certain real property had become worthless prior to the taxable year involved. The taxpayer appealed the decision of the Tax Court to the Seventh Circuit, and that court held, on the authority of the Dobson case, that it could not disturb the finding of the Tax Court.

The Circuit Court of Appeals did not mention the Fox case nor the Superior Coal Company case in its opinion in the instant case, and it made no attempt whatever to show in what respects the instant case is distinguishable from these cases.

In view of the basis upon which the Circuit Court of Appeals predicated its decision, its holding is tantamount to a conclusion that the taxpayer committed a fraud. The decision of the Circuit Court is not based upon the legal effect of any provision in the debentures and the trust instrument issued in connection therewith, but is based upon a conclusion that "it was all a matter of accounting hocus-pocus." This is the same thing as saying that the parties committed a fraud in the issuance of the bonds. At no stage of the proceeding has the Commissioner of Internal Revenue contended that the parties committed a fraud. He did not assert fraud in his notice of deficiency, nor did he

raise this issue by pleading before the Tax Court. Furthermore, since the question of fraud is a pure question of fact, such an issue would most assuredly fall within the sole jurisdiction of the Tax Court under the Dobson case. As Mertens states in his Law of Federal Income Taxation, Sec. 55.11, Vol. 10, p. 18:

“Fraud cases are illustrative authorities because they are premised largely on intent; which is proven not only by records and testimony, but by the appearance and manner of witnesses and inferences to be drawn therefrom.”

The foregoing more forcefully emphasizes the clear-cut error of the Circuit Court of Appeals in reversing the Tax Court in the instant case.

The most that can be said of the decision of the Circuit Court of Appeals is that if that court had been the trial court it would have reached a conclusion different from that reached by the Tax Court, based on the “conflicting factual inferences and conclusions” to be drawn from the evidence. But the Circuit Court of Appeals was not the trial court. It is the function of the Tax Court to hold the trial and to draw conclusions from conflicting factual inferences. In the exercise of this function, the Tax Court did determine the inferences and conclusions to be drawn from the evidence and reached the conclusion that the instruments were bonds and that the holders thereof became creditors of the corporation. Such a holding by the Tax Court is not subject to review by a Circuit Court of Appeals.

## Point II

### THE DECISION OF THE TAX COURT WAS CORRECT ON THE BASIS OF THE MERITS

If we disregard the principle of the Dobson and related cases and consider the case solely from the standpoint of the merits, the decision of the Tax Court was correct.



At the outset, the Petitioner wishes to point out a most important fact in this case, which is, that the instrument involved is unquestionably and undeniably in the form of a bond and not in the form of a capital stock certificate. This becomes of vital importance, for the reason that in the vast majority of cases involving the question of "stock v. bonds," the instruments involved were in form, preferred stock, and the taxpayers were contending that in reality the instruments were bonds. In the instant case, "the shoe is on the other foot." The instrument, in form, is a bond and it is the Government which is claiming that it is something other than what it purports to be.

A review of the decided cases dealing with the question as to whether an instrument is a certificate of stock, or a bond, clearly shows that the form of the instrument is the most important fact to be taken into consideration in the case. While the form of the instrument is not absolutely controlling, the decided cases show that the party who claims that the instrument is something other than what it purports to be on its face is at a decided disadvantage. This is due to the fact that the board of directors of a corporation know the difference between a bond and a preferred stock, and that by adopting the form of the instrument it is presumed that the board of directors intended the instrument to be exactly what it is in form. In the case of *Northern Fire Apparatus Company*, 11 BTA 355, the Tax Court at p. 361 said:

"In law there are material differences between corporate stock and corporate bonds. Boards of directors are presumed to know those differences and when such board issues certificates, the name or designation given such certificates by the board of directors should be given effect, unless there is convincing evidence that the board did not say what it intended to mean, and further that what it intended to say is evidenced so clearly and publicly that creditors will not be misled."

The Tax Court stated that the name given to the instrument will prevail unless there is "convincing evidence" that the board of directors did not say what it intended to. There certainly is no convincing evidence in the present case to show that the board of directors intended the instruments to be anything other than bonds. As a matter of fact, there is convincing evidence to show that the instruments were intended to be bonds.

In the appeal of *Kentucky River Coal Corp.*, 3 BTA 644, 649, the Tax Court said:.

"The first thing to be considered in the determination of whether the shares of debenture stock issued by the taxpayer and outstanding during the year 1919 are obligations of the taxpayer or a part of its capital stock, is the name which has been given to such shares of debenture stock. It is not a thing to be ignored, for it is not lightly to be assumed that parties have given an erroneous name to their transaction."

In the appeal of *O. P. P. Holding Corporation*, 30 BTA 337, 340, the Tax Court said:

"It is the generally accepted rule that the name given to the instrument is not conclusive of its character and that inquiry may be made as to its real character; but it is not lightly to be assumed that parties have given an erroneous name to their transaction. *Leasehold Bldg. Co.*, 3 BTA 1129; *Kentucky River Coal Corp.*, 3 BTA 644. Its true nature will be determined by looking to its terms and legal effect. *I. Unterberg & Co.*, 2 BTA 274."

When the *O. P. P. Holding Corporation* case was considered by the Circuit Court of Appeals for the Second Circuit, 76 F. (2d) 11, that Court said:

"Stocks and bonds both evidence a contract between their holders and the issuing corporation, and, in construing this contract, the language used in reducing it

to writing will be indicative of the intention of the parties."

See also the case of *H. R. DeMilt Company*, 7 BTA 7.

A review of the form of the instrument involved in this proceeding (Exhibit "E," R. 17) demonstrates beyond any question that in form it is a bond. It is referred to at the top of the instrument as "Form of Debenture." It is headed "The John Kelley Company 20-Year 8% Income Debenture." Throughout the entire instrument it is referred to as "debenture" and "this debenture bond." The earnings to accrue on the instrument are referred to as "interest." The same comment applies to the trust instrument under which the bonds were issued and which appears in the record as Exhibit "F," R. 19. At no place do the words "stock" or "preferred stock," or "dividends" appear in the bond itself or in the trust instrument.

When the foregoing facts are taken into consideration and it is realized that the characteristics established by the instrument logically support the name which the board of directors assigned thereto, the conclusion is inevitable that the instrument is a bond and not a preferred stock. Imagine the chance the Petitioner would have if it were contending that the amount of the outstanding bonds should be included in its invested capital on the theory that the holders thereof are stockholders rather than bondholders. Such a contention on the part of the Petitioner would be dismissed as fantastic.

The importance of the form of the instrument is illustrated by the case of *Pacific Southwest Realty Company v. Commissioner*, 128 F. (2d) 815, decided by the Circuit Court of Appeals for the Ninth Circuit. In that case the instruments were admittedly in the form of preferred stock. The Circuit Court of Appeals decided the case against the taxpayer and held that the instruments were preferred stock.

In a concurring opinion, Judge Healy made the following statement:

"If they had been denominated 'bonds' rather than preferred stocks, I apprehend that nobody would contend that they were not true evidences of debt or that the returns paid thereon were anything other than interest."

In other words, if the instruments in the Pacific Southwest Realty Company case had been in the form of bonds and every other essential element had been the same as it actually was, the decision would have been in favor of the taxpayer for the reason that when Judge Healy stated that if these conditions had obtained "nobody would contend that they were not true evidences of debt," he certainly was including his colleagues.

By holding that the issuance of the bonds was merely a matter of "accounting hocus-pocus," the Circuit Court of Appeals reversed the finding of the Tax Court that the parties intended to become creditors of the corporation. Regardless of anything else that may have been in the case for the consideration of the Circuit Court of Appeals, certainly the question of intent was not included. As the Petitioner has already pointed out in this brief, the question of "intent" is the purest kind of question of fact. The Tax Court held that it was the intent of the bondholders to become creditors, and the only possible question for review by the Circuit Court of Appeals was to ascertain if the steps taken were sufficient in law to carry out that intent.

The Petitioner took every step normally taken in the issuance of corporate bonds. It provided for the bonds by appropriate action of its board of directors and its stockholders. It approved the trust instrument under which the bonds were to be issued. It adopted the wording of the bond which is undeniably in the form of the usual corporate bond. It redeemed its preferred stock and its preferred stockholders took bonds of a face value of \$102 per share for each

share of preferred stock of a par value of \$100. In addition, the Petitioner sold bonds of a face value of \$24,408 to Mabel K. Ronald and bonds of a face value of \$10,944 to Birdena Kelley, which were paid for at face value through dividends which Mabel K. Ronald and Birdena Kelley received on common stock which they owned. During the years 1937, 1938 and 1939, all of the issued bonds remained outstanding and none of them were redeemed or cancelled.

It is difficult to see what additional steps the Petitioner could or should have taken in the issuance of the bonds. It followed the procedure which is normally followed by any corporation in the issuance of bonds. Consequently, it cannot be claimed that what it did failed to carry out the intent to create the relationship of debtor and creditor—and the Tax Court found, as a fact, that this relationship exists.

The only unusual circumstances found in the entire transaction is the fact that the payment of interest is conditioned upon profits of the company and that the obligation under the bonds is subordinate to the claims of general creditors. But the Tax Court considered both of these points and held that they did not change the bond into a preferred stock.

In the case of *H. R. DeMilt Company*, 7 BTA 7, the bonds provided that the interest was to be "payable only out of surplus or net profits." In that case it was the taxpayer who claimed that the bonds were stock, since the taxpayer wanted to include them in invested capital. In speaking of the interest provisions the Tax Court said:

"Nor do we think the fact that the interest was to be paid out of 'surplus or net profits' would be controlling. We are concerned here with the principal itself, which is an enforceable lien against the assets of the corporation and which is subject to repayment in twenty years."

Furthermore, the bonds involved in the DeMilt case contained a provision whereby the obligation of the company



under the bonds was subordinate to the claims of general creditors, but the Tax Court held that such a provision did not cause the instrument to be classified as a preferred stock. See also the cases of *Commissioner v. Page Oil Co.*, 129 F. (2d) 748, *Idaho Lumber & Hardware Co.*, T. C. Memo. Dec., Par. 45,084, P.-H. Memo Service; *Fidelity Finance Service, Inc.*, T. C. Memo. Dec., Par. 42,467, P.-H. Memo. Service, and *S. Glaser & Sons, Inc.*, T. C. Memo. Dec., Par. 44,170, P.-H. Memo. Service.

In the case of *Arthur R. Jones Syndicate v. Commissioner*, 23 F. (2d) 833, the *Seventh Circuit* held that the subordination of the claims of the holders of the instruments to general creditors of the issuing corporation was not sufficient to cause a bond to be classified as preferred stock and the court reached this conclusion regardless of the fact that in the Jones case the instrument, in form, was a stock certificate, and not a bond:

A similar provision was contained in the bonds involved in the appeal of *O. P. P. Holding Corporation*, 30 BTA 337. In that case the Tax Court, at page 341, said:

"In the instant case there is nothing in the instrument to make the holder thereof a stockholder. It is true that the debenture bonds are subordinate to the claims of all creditors of the corporation, but this does not mean that the holder of a debenture bond is not also a creditor."

The Commissioner of Internal Revenue appealed the case of *O. P. P. Holding Corporation* to the Circuit Court of Appeals for the Second Circuit and the decision of the Tax Court was sustained in 76 F. (2d) 11. In speaking of the priority of the claims of general creditors over the claims of bondholders, the Circuit Court said:

"We do not think it fatal to the debenture holder's status as a creditor that his claim is subordinated to those of general creditors. The fact that ultimately he must be paid a definite sum at a fixed time marks

his relationship to the corporation as that of creditor rather than shareholder. The final criterion between creditor and shareholder we believe to be the contingency of payment."

The Second Circuit hit the keynote when it stated that the vital difference between a creditor and a shareholder is the obligation of payment on a date definite. A stockholder has an investment in the business of the corporation and he is not entitled to receive a return on his investment until the company is liquidated or the board of directors decide to redeem his stock. On the other hand, a bondholder has an instrument that becomes due on a fixed date and on that date the bondholder is entitled to receive payment out of the assets of the company even though such payment may not be in accord with the wishes of the board of directors. Since the definite maturity date is the outstanding characteristic of a bond as compared to preferred stock, let us look at this feature as it applies to the bond of Petitioner.

As far as the bond itself is concerned, there can be no question about the definiteness of the liability of the Petitioner to pay. The very first statement in the bond reads as follows:

"The John Kelley Company, an Indiana corporation, for value received, promises to pay to the bearer on the 31st day of December 1956, the sum of \$1,000 in lawful money of the United States of America at the office of the Company in Marion, Indiana: • • •"

The trust indenture (Exhibit "F," R. 19) under which the bonds were issued provides as follows in Sec. 1 of Article II:

"Section 1. The Company covenants that it will promptly pay or cause to be paid to every holder of any debenture issued hereunder the principal and interest accruing thereon in lawful money of the United States of America, on the dates and at the place and in the manner mentioned in said debentures. The interest on

the debentures shall be payable only upon presentation thereof for endorsement thereon."

Sec. 2 of Article IV of the trust instrument provides as follows:

"Section 2. The company covenants that (a) in case default shall be made in the punctual payment of any installment of interest on any outstanding debenture or debentures and such default shall have continued for a period of two (2) years; or (b) in case default shall be made in the payment of the principal of any such debenture or debentures when the same shall become payable, whether upon maturity or upon call or declaration as provided in this Trust Agreement, then upon demand of the Trustees the Company will pay to the Trustees for the benefit of the holders of the debentures issued hereunder and then outstanding, the whole amount which then shall have become due and payable on all such debentures then outstanding and in addition thereto such further amount as shall be sufficient to cover the costs and expenses of collection, including a reasonable compensation to the Trustees, their agents, attorneys and counsel, and any expenses or liability incurred by the Trustees hereunder. In case the Company shall fail forthwith to pay such amount on such demand, the Trustees in their own names and as Trustees of any express trust shall be entitled and empowered to institute such action or proceeding at law or in equity, as may be advised by counsel, for the collection of the sums so due and unpaid and may prosecute any such action or proceeding to judgment or final decree and may enforce any such judgment or decree in the manner provided by law."

And in the last paragraph of Sec. 5 of Article IV it is provided:

"Provided, however, that nothing in this Trust Agreement shall affect or impair the obligation of the Company, which is unconditional and absolute, to pay, at the date of maturity therein expressed the principal

of the debentures to the respective holders thereof, or affect or impair the right of action of such holders to enforce such payment, subject only to the prior right of the Trustees, if exercised promptly in accordance with the terms of this Trust Agreement."

The foregoing quoted provisions of the bond and the trust instrument clearly demonstrate that the liability of the Petitioner to pay the amount of the bonds is definite and fixed and if the bonds are not redeemed by the company prior to December 31, 1956, the Petitioner at that time must pay the principal and the interest due out of its available assets, regardless of the wishes or decision of its board of directors and regardless of whether it must impair its capital in order to make payment. Under these circumstances, the instruments are clearly bonds and not preferred stock.

In the case of *O. P. P. Holding Corporation*, 30 BTA 337, the Tax Court, at page 341, stated that the essential elements of a bond are: "A definite obligor; a definite obligee; a definitely ascertainable obligation; a time of maturity, either definite or that will become definite." Let us apply this definition of a bond to the instant case. The Petitioner is the definite obligor under the bond. It obligated itself to pay the amount as indicated by the bonds that were issued. The holders of the bonds are the definite obligees. They are entitled to demand and receive the principal amount of the bond and interest in accordance with the terms of the bond and the trust instrument under which they were issued. There is a definite ascertainable obligation to pay. Each bond states on its face the amount to which the payee is entitled when the bond matures. The time of maturity is absolutely definite. Unless sooner redeemed by the company in accordance with the terms of the trust instrument under which the bonds were issued, they will mature on December 31, 1956, and at that time the holders of any outstanding bonds will have the absolute right to demand payment and the Petitioner will have no recourse except to make payment to the full extent of its available property. It can

be seen, therefore, that the income debentures satisfy all of the requirements which the Tax Court in the O. P. P. Holding Corporation case stated must be present in order to constitute an instrument a bond.

Furthermore, in addition to the definite fixed date for the payment of the principal of the bond, plus interest in accordance with terms thereof, we find that the instruments are negotiable and are payable to bearer; that no assignment is required; no transfer is necessary on the books of the company or on the stock records; and that the interest becomes absolutely due if there are profits, without any action on the part of the board of directors to create the liability. In the case of stock, the holder thereof is entitled to receive dividends only in the event that the board of directors of the company decide to pay such dividends and it is only in the case of a showing of fraud that a court will assist the stockholders and compel the declaration of dividends. If the bonds in the instant case are not redeemed before December 31, 1956, the holders of the bonds at that time need not depend upon any discretion or decision by the Petitioner Corporation to receive payment on their bonds. The obligation to pay will then arise through lapse of time and unless payment is made, the holders of the bonds can successfully compel payment through court action. The foregoing characteristics are those of bonds rather than preferred stock.

The Petitioner could discuss many cases in which instruments in the form of bonds, and even instruments in the form of preferred stock, were held to create the relationship of "debtor and creditor," however, the factual situation in each case is so varied as compared to any given case, that it is believed such a discussion would unduly lengthen this brief. The case which seems to most nearly fit the facts in the instant case is that of *Commissioner v. H. P. Hood and Sons, Inc.*, 141 F. (2d) 467, decided by the Circuit Court of Appeals for the First Circuit.

In the Hood case, the Hood Company had outstanding preferred stock. In 1936 an issue of "7% income debentures"



tures" was created and pursuant to a vote of the corporation, the debentures were offered in exchange on a par for par basis to the holders of the preferred stock. During the calendar years 1936 to 1940, inclusive, 29,498 shares of preferred stock of a par of \$100 per share were exchanged for debentures. The company also sold \$60,000 face amount of debentures for cash. The interest was payable quarterly, "only out of and to the extent of the net profits of the company." Any unpaid interest was cumulative. "The company reserved the right to issue other notes, debentures, bonds, or other obligations" in priority to the debentures. The Tax Court held that the debentures were bonds and that the company was entitled to deduct the interest paid thereon in arriving at taxable net income. The Commissioner appealed the case to the Circuit Court of Appeals for the First Circuit. The First Circuit sustained the Tax Court, and it is interesting to note that one of the principal authorities relied upon by the Circuit Court of Appeals in deciding that the instruments were bonds was the decision of the Tax Court in the case of *John Kelley Company*, 1 T. C. 457—the very case which is being argued in this brief. The Circuit Court pointed out that the subordination of the bondholders to the claims of other creditors was not fatal to the debenture holders' status as a creditor, and it also pointed out that it made no difference that the interest was payable "only out of and to the extent of the net earnings of the company." The only material difference in the facts in the Hood case as compared to the facts in the instant case is that unpaid interest was cumulative in the Hood case, whereas, in the instant case it is not. But this difference is not sufficient to cause the instruments in the Kelley case to fall within a different classification than those in the Hood case. Innumerable loans are made where no interest is provided for and where there is no intent that any interest will ever be paid, but, surely, this fact alone does not destroy the relationship of "debtor-creditor" between the parties. If the total absence of interest is insufficient to destroy the relationship of

"debtor-creditor" in a proper case, certainly, a provision for the payment of interest only in the event that certain conditions exist, would not have that result.

A further interesting observation may be made with respect to the Hood case. The Circuit Court stated that it was the type of case in which the decision of the Tax Court was final, in the light of the Dobson case. In this connection the Circuit Court said:

"Since each case involving the question here presented must largely turn on its special facts, and since the Tax Court applied the correct rule of law, its determination is entitled to the finality indicated by *Dobson v. Helvering*, 320 U. S. — (1943)."

The Government did not apply for a writ of certiorari in the Hood case.

There remains one further question for discussion. At R. 57 and 58, the Circuit Court of Appeals emphasized the fact that the books of the corporation referred to the bonds "variously as 'stocks,' 'bonds' and 'notes,'" and that on the capital stock, income, and excess profits tax returns, the debentures were listed under "Capital Stock: Debenture Notes." The Tax Court found (R. 36) that even though the debentures were listed on the tax returns under heading "Capital Stock," nevertheless, the entry under this heading was "Debentures" and "Debenture Notes." The Commissioner of Internal Revenue was the one who took the affirmative in the introduction of evidence to show that in certain instances the books and records of the Petitioner referred to the debentures as "stock." In rebuttal, the Petitioner introduced evidence to show the instances in which its books and records referred to the debentures as "debentures," "bonds" and "notes." It is the position of the Petitioner that it makes no difference by what name or names the instrument, or the income arising therefrom, may have been recorded on the books and records of the Petitioner Corporation if such recordation is contrary to the actual facts.

It is now well settled in our income tax law that the method of recording a transaction on the books and records of a taxpayer, or the name which the taxpayer may assign to a given transaction, means nothing if the recorded entries and the names used are contrary to the essence of the transaction.

A thing is what its essence constitutes it to be and this essence is not changed by any name which the parties may use in recording the transaction on its books. In the case of *Doyle v. Mitchell*, 247 U. S. 179, this Court said:

"Nor is the result altered by the mere fact that the increment of value had not been entered upon plaintiff's books of account. Such books are no more than evidential, being neither indispensable nor conclusive. The decision must rest upon the actual facts, which, in the present case, are not in dispute."

See also the cases of *Douglas v. Edwards*, 298 Fed. 229, and *United Profit-Sharing Corporation v. United States*, 66 Ct. Cls. 171. The Tax Court has announced the same principle in many cases and it would serve no purpose here in making a detailed reference to such decisions.

The same principle applies to the entries on the balance sheet attached to the capital stock, income and excess profits tax returns. As pointed out above, the debentures were listed on the returns under the heading "Capital Stock," nevertheless, the actual reference under this heading was to "debentures" and "debenture notes." The important point is that by entering the securities under the heading "Capital Stock" on the capital stock, income and excess profits tax returns, the Petitioner received no tax benefit, and its liability for taxes would have been exactly the same had the bonds been listed under "Liabilities" instead of, under "Capital Stock." The Commissioner is not contending that the inclusion of the income debentures under the heading "Capital Stock" on the capital stock, income or excess profits tax returns resulted in a tax benefit to the Petitioner or

that the principle of estoppel should be applied. Under these circumstances, the entries made on the respective returns fall in the same category as the other book entries and they neither bind the government nor the taxpayer.

It is the position of the Petitioner that neither it nor the Respondent can get any consolation out of the fact that in certain instances the debentures were referred to on the books and records of the corporation variously as "stocks," "bonds" and "notes" and that the question must be decided on the basis of the instruments themselves and the method that was followed in their issuance. In addition to all that has been stated above, the testimony of Roy Kelley, Secretary and Treasurer of the Petitioner, concerning this point will be found at R. 14 and 15. Mr. Kelley testified that the confusion in the records was evidently caused by the different bookkeepers employed by the Petitioner who seemed "to call the debentures anything they wanted" and that the first time he knew of the discrepancies in the names used was when the revenue agent made his investigation in the fall of 1940 and called his attention to it. Of course, the record shows that the Tax Court took the above facts into consideration before reaching its conclusion that the instruments were bonds and not preferred stock (R. 36). See also the memorandum decision of the Tax Court in the case of *Charles Olson & Sons, Inc.*, Docket No. 109,980, reported at Par. 42,594 Prentice-Hall Memorandum Decisions Service 1942.

Wherefore, it is submitted that whether this case be considered from the standpoint of the principle of the Dobson case and related cases, or solely from the standpoint of the merits, the decision of the Tax Court was correct, and that the decision of the Circuit Court of Appeals should be reversed.

Respectfully submitted,

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